No. 95-559

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

vs.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

REPLY BRIEF FOR PETITIONERS

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I. THE MONTANA NOTICE STATUTE IS PREEMPTED BY THE FEDERAL ARBITRATION ACT.

Respondents do not dispute either of the two points that are essential to answering the straightforward question presented by the petition. One, the parties entered into a written agreement to arbitrate involving interstate commerce that met all of the requirements of Section 2 of the Federal Arbitration Act ("FAA"), which makes written agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Two, the Montana Supreme Court refused to enforce the agreement to arbitrate on the ground that it did not comply with a notice requirement under Montana law that is applicable only to arbitration agreements and not to other types of agreements. Under the plain and unequivocal

language of Section 2 and the decisions of this Court, those two points alone are sufficient to find preemption of the Montana notice statute. *See* Pet. 11-17.

Rather than address those two central points, respondents instead attempt to justify the Montana Supreme Court's decision on the basis of a rationale not even relied upon by that court. According to respondents, the Montana court applied the Montana arbitration notice requirements because the parties had "expressly agreed to apply state law" to their franchise agreement. Br. in Opp. 7. Therefore, according to respondents, the Montana Supreme Court's decision not to enforce the agreement to arbitrate on the basis of Montana law was appropriate under *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), because the decision below purportedly was based on "a state court's application of standard conflict-of-law principles and carefully calibrated state rules of arbitration to a contract in which the parties *agreed to abide by state law*." Br. in Opp. 9 (emphasis added).

There are, however, several obvious problems with respondents' argument. First, the parties did not agree to apply just any "state law" to their agreement; the choice-of-law clause in the franchise agreement expressly provided that the agreement "shall be governed by and construed in accordance with the laws of the State of Connecticut." Pet. App. 15a. Respondents do not dispute that Connecticut law has no notice requirement comparable to Montana's. Thus, it is undisputed that the parties' agreement to arbitrate is enforceable under the state law chosen by the parties. *See* Conn. Gen. Stat. § 52-408 (1995).[1]

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[1] As is common practice, the parties' agreement to arbitrate also provided that any arbitration proceedings would be "in accordance with the Commercial Arbitration Rules of the American Arbitration Association." Pet. App. 13a. This Court has looked to the arbitration rules incorporated by reference in an arbitration agreement when determining the scope of the agreement. *See Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1218 (1995). Respondents do not even address the parties' *(Footnote continued)*

Second, the Montana Supreme Court did not base its decision on a finding that the parties *intended* to apply Montana law to their agreement; nor could it have done so given the parties' unambiguous choice of Connecticut law. Instead, the Montana Supreme Court refused to apply the law chosen by the parties, precisely because to do so "would be contrary to a fundamental policy of this State by eliminating the requirement that notice be provided when a contract is subject to arbitration." Pet. App. 18a-19a.[2]

Third, therefore, respondents' reliance on *Volt* simply does not hold up. Unlike the situation in *Volt* where the state court applied the law chosen by the parties in their contract, the court in this case did just the opposite: it *refused* to enforce the state law that the parties had selected in their contract. Indeed, the court below very clearly distinguished this case from *Volt* by stating as follows: "While the Court in *Volt* applied state laws that had been chosen by the parties in their contract, . . . this case involves state law which is applied pursuant to conflict of law principles . . . ." Pet. App. 25a. Because the parties here chose a law other than Montana's, it can hardly be said that applying Montana law to invalidate the parties' agreement to arbitrate enforces the intent of the parties, which was the rationale for the decision in *Volt*. *See Volt*, 489 U.S. at 478; *Mastrobuono v. Shearson Lehman Hutton,*

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agreement to abide by the rules of the American Arbitration Association, which--like Connecticut law--do not impose any arbitration notice requirement.

[2] Respondents' comment that it is within the power of Doctor's Associates, Inc. ("DAI") to include in its franchise agreements a provision to avoid the application of state arbitration law, Br. in Opp. 15, is disingenuous given that DAI did just that in this instance by selecting Connecticut law and the rules of the American Arbitration Association in lieu of any other state's law. It is therefore impossible to fathom what more respondents believe DAI could have done to avoid application of Montana law. Of course, under the analysis employed by the Montana Supreme Court, Montana law would apply to the parties' agreement to arbitrate regardless of the law selected by the parties.

Inc., 115 S. Ct. 1212, 1216 (1995). And, because respondents' argument begins and ends with the decidedly false assumption that the parties here intended the Montana notice statute to govern their relationship--an assumption not even indulged in by the Montana Supreme Court--they are left with no defense of the decision below.[3]

What the Montana Supreme Court did decide is that Montana law, even when *not* chosen by the parties (and, more particularly, even when the parties had chosen a different state's law), could invalidate an agreement to arbitrate despite the fact that the Montana law was arbitration-specific and did not govern contracts generally. The sole basis of that decision was a misreading of *Volt* that the preemptive scope of Section 2 is limited to laws that "undermine the goals and policies of the FAA" and that the notice statute does not fall within that category. Pet. App. 25a. That misreading of *Volt* has already been thoroughly addressed in the petition,[4] and respondents

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[3] Under the recent decision in *Mastrobuono*, Montana's notice statute would be preempted even if, hypothetically, the parties *had* agreed to let Montana law govern their franchise agreement. In *Mastrobuono*, the Court characterized a choice-of-law provision similar to the one here as merely serving as "a substitute for the conflict-of-laws analysis that otherwise would determine what law to apply to disputes arising out of the contractual relationship." 115 S. Ct. at 1217. The Court found "untenable" an interpretation of the choice-of-law clause that would put the clause in conflict with the contract's arbitration clause. *Id.* at 1219. It would be even more absurd, and in conflict with the federal policy favoring arbitration and construing ambiguities in favor of arbitration (*see id.* at 1218 & n.8), to rule on the basis of a choice-of-law clause that the parties agreed to an arbitration clause in their franchise agreement at the same time as they intended to incorporate Montana law invalidating that arbitration clause for failure to include the prescribed notice on the first page of the agreement. Certainly, *Volt* does not dictate such a bizarre result, and the Montana Supreme Court did not reach that result, as it applied Montana law contrary to the parties' intent.

[4] Briefly, *Volt* did not address whether an arbitration agreement should be enforced; it dealt only with whether a state law governing the timing of arbitration could be enforced by a state court when the parties had chosen that law to govern their agreement, and where the state law fostered the

(Footnote continued)

have said nothing to question petitioners' analysis that state laws conditioning enforcement of arbitration agreements on compliance with particular state requirements are preempted unless they apply to contract provisions generally, and not just to arbitration provisions.

While respondents baldly state that the Montana court's decision is in harmony with *Terminix*, Br. in Opp. 7, 8, they do not and cannot reconcile the decision below with *Terminix*'s reaffirmation of the preemptive scope of Section 2 as recognized in this Court's earlier decisions. *See Terminix*, 115 S. Ct. at 838-39; *Perry v. Thomas*, 482 U.S. 483, 489-91 & 492 n.9 (1987); *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983). Respondents do not even acknowledge the language in *Terminix*, quoted on page 13 of the petition, that "States may not . . . decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. *The Act makes any such state policy unlawful* . . . ." *Terminix*, 115 S. Ct. at 843 (emphasis added). Instead, like the Montana court, respondents ignore the quoted passage and extol the virtues of a notice statute that admittedly applies only to arbitration agreements and not to other contract terms. *See* Br. in Opp. 8-9. Respondents, therefore, cannot avoid the inescapable conclusion that the notice statute is preempted by Section 2.

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federal policy favoring arbitration by addressing a practical problem that the FAA failed to address. *See* 489 U.S. at 476 n.5, 478. It is still the case that Section 2 preempts state laws that place arbitration agreements on an unequal footing with other contracts, as such laws are "*directly* contrary to the Act's language and Congress's intent." *Allied-Bruce Terminix Companies v. Dobson*, 115 S. Ct. 834, 843 (1995) (emphasis added). Respondents do not take issue with petitioners' analysis of the Montana notice statute as placing arbitration agreements on a different footing from other contracts. Nevertheless, even if respondents (and the Montana Supreme Court) were correct in their interpretation of *Volt*, the resulting tension between *Volt* and *Terminix* would itself warrant this Court's review.

II. THIS CASE IS APPROPRIATE FOR REVIEW.

Respondents attempt to minimize the conflict between the decision below and the decisions of the U.S. Courts of Appeals for the First, Second and Eighth Circuits and the Missouri Supreme Court. *See* Br. in Opp. 9-13. They do so principally on the ground that the parties here "selected state law" but that the parties in the cases cited by petitioners did not so agree. *See* Br. in Opp. 12. Because, as we have discussed, the parties did *not* agree to be bound by the Montana notice statute relied on by the court below, respondents' effort to distinguish the contrary authority falls of its own weight. Moreover, as explained in the petition, both the Second and First Circuits found preemption of notice provisions *after Volt*, with the latter expressly distinguishing *Volt* in finding preemption under Section 2. *See David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1119 n.3 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990).

Thus, the conflict between the courts below is real and substantial. Moreover, the issue is of considerable importance. If the decision of the Montana Supreme Court is allowed to stand, other jurisdictions hostile to arbitration may feel free to follow Montana's erroneous interpretation and application of *Volt* and refuse to enforce arbitration agreements on the basis of state-law requirements that are not applicable to contracts generally. Indeed, having previously vacated the judgment below and remanded the case for reconsideration in light of *Terminix*, a decision now by this Court not to review the decision reinstated below could mistakenly be seen as a signal to other courts that the Montana court was correct in its interpretation of the preemptive scope of Section 2. Such a result would inevitably disrupt the national uniformity that Congress sought to achieve in enacting the FAA.

Respondents argue that the Court should deny review and wait for a future case that "may provide a more straightforward vehicle, without the need for this Court to engage in a

conflict-of-law analysis." Br. in Opp. 13-14. But this Court need not engage in any conflict-of-law analysis to resolve the straightforward question presented by the petition. While, as stated in the petition, petitioners believe that the Montana court erred in its conflicts analysis, it is unnecessary for this Court to reach out and decide that issue because the Montana notice statute, which concededly applies only to agreements to arbitrate and not to contracts generally, is in any event preempted by Section 2. *See* Pet. 14 n.10.[5]

Respondents finally contend that review by this Court is unnecessary because the Montana legislature and high court have not demonstrated "hostility" toward arbitration. Br. in Opp. 14-15. But the court below itself acknowledged that the notice statute embodies Montana public policy that is suspicious of arbitration as inconvenient, expensive and devoid of the procedural safeguards of a judicial proceeding. Pet. App. 19a-20a. That attitude seems "hostile" in any normal sense of that term. In any event, the fact remains that the notice statute places agreements to arbitrate on a different footing from other agreements, and for that reason may not be applied to agreements to arbitrate that, like the one here, meet all of the requirements for enforceability under the FAA. *See Terminix*, 115 S. Ct. at 838.

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[5] Respondents also argue that this case is an inappropriate vehicle for reaching the issue presented in the petition because the Court will be required to decide whether petitioner Nick Lombardi, who was not a signatory to the agreement to arbitrate, may enforce the agreement as DAI's agent. Br. in Opp. 14; *see also id.* at 1 n.1. The Montana trial court, however, ruled that the claims against Lombardi were encompassed by the arbitration agreement and that the claims against Lombardi should be stayed pending arbitration. Pet. App. 50a. The Montana Supreme Court did not reach that specific issue. *See* Pet. App. 15a. This Court can therefore decide the issue presented in the petition without concerning itself with whether the Montana trial court erred by staying the claims against Lombardi. That issue can be raised by respondents on remand if still appropriate. In any event, respondents' arguments regarding Lombardi have no bearing on the petition of DAI.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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